

§ 1.460-1 Accounting for long-term contracts in general. [Reserved]

§ 1.460-2 Definition of long-term contract. [Reserved]

§ 1.460-3 Percentage of completion method. [Reserved]

§ 1.460-4 Methods of accounting for long-term contracts.

(a)-(i) [Reserved]

(j) *Consolidated groups and controlled groups*—(1) *Intercompany transactions*—

(i) *In general.* Section 1.1502-13 does not apply to the income, gain, deduction, or loss from an intercompany transaction between members of a consolidated group, and section 267(f) does not apply to these items from an intercompany sale between members of a controlled group, to the extent—

(A) The transaction or sale directly or indirectly benefits, or is intended to benefit, another member's long-term contract with a nonmember;

(B) The selling member is required under section 460 to determine any part of its gross income from the transaction or sale under the percentage-of-completion method (PCM); and

(C) The member with the long-term contract is required under section 460 to determine any part of its gross income from the long-term contract under the PCM.

(ii) *Definitions and nomenclature.* The definitions and nomenclature under § 1.1502-13 and § 1.267(f)-1 apply for purposes of this paragraph (j).

(2) *Example.* The following example illustrates the principles of paragraph (j)(1) of this section.

Example. Corporations P, S, and B file consolidated returns on a calendar-year basis. In 1996, B enters into a long-term contract with X, a nonmember, to manufacture 5 airplanes for \$500 million, with delivery scheduled for 1999. Section 460 requires B to determine the gross income from its contract with X under the PCM. S enters into a contract with B to manufacture for \$50 million the engines that B will install on X's airplanes. Section 460 requires S to determine the gross income from its contract with B under the PCM. S estimates that it will incur \$40 million of total contract costs during 1997 and 1998 to manufacture the engines. S incurs \$10 million of contract costs in 1997 and \$30 million in 1998. Under paragraph (j) of this section, S determines its gross income from the long-

term contract under the PCM rather than taking its income or loss into account under section 267(f) or § 1.1502-13. Thus, S includes \$12.5 million of gross receipts and \$10 million of contract costs in gross income in 1997 and includes \$37.5 million of gross receipts and \$30 million of contract costs in gross income in 1998.

(3) *Effective dates*—(i) *In general.* This paragraph (j) applies with respect to transactions and sales occurring pursuant to contracts entered into in years beginning on or after July 12, 1995.

(ii) *Prior law.* For transactions and sales occurring pursuant to contracts entered into in years beginning before July 12, 1995, see the applicable regulations issued under sections 267(f) and 1502, including §§ 1.267(f)-1T, 1.267(f)-2T, and 1.1502-13(n) (as contained in the 26 CFR part 1 edition revised as of April 1, 1995).

(4) *Consent to change method of accounting.* For transactions and sales to which this paragraph (j) applies, the Commissioner's consent under section 446(e) is hereby granted to the extent any changes in method of accounting are necessary solely to comply with this section, provided the changes are made in the first taxable year of the taxpayer to which the rules of this paragraph (j) apply. Changes in method of accounting for these transactions are to be effected on a cut-off basis.

[T.D. 8597, 60 FR 36684, July 18, 1995]

§ 1.460-5 Cost allocation rules. [Reserved]

§ 1.460-6 Look-back method.

(a) *In general*—(1) *Introduction.* With respect to income from any long-term contract reported under the percentage of completion method, a taxpayer is required to pay or is entitled to receive interest under section 460(b) on the amount of tax liability that is deferred or accelerated as a result of overestimating or underestimating total contract price or contract costs. Under this look-back method, taxpayers are required to pay interest for any deferral of tax liability resulting from the underestimation of the total contract price or the overestimation of total contract costs. Conversely, if the total contract price is overestimated or the